THE ABSORPTION OF FOREIGN OBLIGATIONS BY SAVINGS BANK AND TRUSTEE INVESTORS

MILTON HARRISON
Secretary, Savings Bank Section, American Bankers Association

THERE are two causes which would lead to caution on the part of savings bank or trustee investors in a risk involved in investment in so-called foreign obligations: first, a lack of understanding of the security, and thus a presumed uncertainty of payment of the debt at maturity; and, second, inadequate marketability and the precedence of American government and municipal securities over foreign government and municipal obligations.

The high-grade trustee investor is rather inclined to follow closely the investment restrictions imposed on mutual savings banks. There is justification in following such an example as the mutual savings banks, particularly those of the State of New York which have maintained the highest level of safety and soundness. In New York, if a trustee closely observes the savings bank law pertaining to investment of funds, he is relieved of personal liability in the event of any loss.

The history of the mutual savings institution as such has demonstrated the desirability of the highest conservatism in the investment of funds. Thus it is natural for the managers of these institutions to scrutinize carefully any new field of investment. After some years of close contact with the mutual savings banks the writer is convinced of the wisdom of this policy. For example, the savings banks of the State of New York were given the right to invest in railroad bonds by the legislature of 1898. The savings banks of New York State, through their association, however, discussed the advisability of opening the field of investment to railroad bonds several years before this time, regardless of other mutual savings bank states having passed acts permitting investment in railroad bonds as early as 1876. Within a few months after the New York banks were permitted to invest in railroad bonds, 47 out of 130 banks in the state had invested $8,851,000 in such bonds.

However, it was not until 1903 that there was any substantial increase in the investment in this character of obligations. Railroad bonds became an exceptionally attractive investment to the savings bank of the state, although selling at a basis as low as 3 per cent. The report of the Superintendent of Banks of the State of New York for January 1, 1903, indicates investment of $151,919,779 in railroad bonds by 116 banks out of 127, or 12.8 per cent. of resources.

While the investment in railroad bonds of the savings banks of the State of New York since 1903 has more than doubled in amount, yet the proportion of increase to total resources has advanced only about four per cent. This simply may indicate a trend of the process of investment by mutual savings banks in a security new to them.

Much has been written of late as to the necessity for the absorption of a large quantity of foreign obligations by American investors. In order to lend stability to the international financial situation the pressure of this necessity may tend to hasten the day when the funds of the savings bank and trustee investors will be invested to a substantial amount in foreign obligations. The example given above of investment in railroad securities may not altogether indicate the probable tendency respecting investment in foreign obligations; however, savings banks may curtail to a considerable degree their future investment in railway issues. Thus, they may be attracted to foreign government and municipal bonds sooner than they would ordinarily.

An amendment to the law of New York State permitting such investment has not as yet been proposed to the legislature, nor has it been seriously discussed by the Savings Banks Association of the State of New York, which is the authoritative representative body for savings banks of that state. However, during the last session of the legislature of Connecticut a bill was passed permitting savings banks to "invest not exceeding 10 per centum of their deposits and surplus in the obligations of the government of the Kingdom of Great Britain and Ireland, and the government of the French people, and the government of the Dominion of Canada, or any of its provinces, provided such obligations have a fixed and definite maturity and shall be the direct obligations of such government or province, and

that the full faith and credit of such government or province shall be pledged for its payment, principal, and interest."

It is by no means certain that the other mutual savings bank states will follow the wording of this law which would permit investment in the bonds of British Columbia, for example, which may not be exactly up to the standard of what a savings bank security should be. The restrictions which will be imposed on foreign obligations by such states as New York and Massachusetts will doubtless be more closely defined, possibly to include such bonds as those which were issued by the American Foreign Securities Company in 1916 which was an issue of $94,500,000 dated August 1, 1919, for three years at 5 per cent., secured by bonds of foreign governments owned by the French government under its pledge to the American Foreign Securities Company. It is reasonable to assume that foreign securities companies will be formed with this very purpose in mind. This will bring the obligor closer to the investor.

At the recent conference of the Council on Foreign Relations "On the investment of American capital abroad" the problem of bringing the obligor closer to the American investor was discussed. The thought was advanced that certain foreign government and municipal obligations could possibly be guaranteed by the United States Government or a group of responsible American bankers. Of necessity, of course, foreign obligations in which savings bank investors would be permitted to invest will be restricted to government or highest grade municipal issues, and of necessity there will be many of such issues. Possibly foreign industries may become financed by American capital furnished by savings bank and trustee investors through the obligations of their governments. This is conceivable. There will be sufficient capital available for lending to foreign countries, even though the needs of our own country may be very great when one considers the billion dollar borrowing program of the states together with the demands of municipalities, railroads, and public utilities, as well as temporary financing of the Federal government in anticipation of taxes. As a consequence, it is difficult to estimate the amount of capital which may be available for the purposes of foreign investment.

The resources of the 625 mutual savings banks in the United States are close to five billion dollars. The gross income alone

on this sum is about 250 million dollars. Due to the intensive encouragement of thrift these banks are increasing deposits to an unusual amount. Thus, if the managers of these institutions can be interested in the absorption of foreign obligations and the necessary enabling acts are passed by the state legislatures, there is every reason to believe that the savings banks can be depended upon to absorb a relatively large amount of foreign obligations provided they are assured of the absolute safety and soundness of the security offered.

There is no institution in the country which is better equipped to handle the public's savings with assurance of safety than the mutual savings banks. It is because of such reputation that trustees generally follow the restrictions placed upon the investment of savings funds. The savings banks realize their responsibility in aiding to maintain international finance.

At the recent meeting of the Executive Committee of the Savings Bank Section of the American Bankers Association at White Sulphur Springs, West Virginia, a resolution was adopted favoring " investment by savings banks in high grade foreign securities in order to further the stability of international finance and directing the committee on investments to study the character of foreign securities which should be eligible for investment by savings banks; and further, that restrictions be developed safeguarding the funds invested in foreign obligations and placed in the form of a bill eventually to be submitted to state legislatures for their action. For like reason we furthermore urge upon the people of this country the vital necessity of their individually purchasing substantial amounts of such foreign securites as may be determined to be safe investments for savings institutions."

The solution of the problem of providing adequate capital for home and abroad seems to be the burden placed upon America and presents a huge task, which depends foremost upon the ability of the individual to save and conserve. The American capitalist is the American public. If thrift is practiced and waste eliminated, the institutions which gather the savings of the people will be in a position to do their part to provide the sinews of peace.